Testimony of Congressman Gregory W. Meeks
Before the Government Reform Committee
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Thank you, Chairwoman Miller, and Ranking Member Lynch. I remember back in 2002 when the Enron scandal began to unfold. Week by week we learned more about the machinations of the senior executives of Enron that would ultimately lay low the seventh largest company in America, as well as one of the Big Six accounting firms. Immediately after that the Worldcom scandal took front and center. Following the aftermath of numerous hearings which included witnessing one senior executive after another plead the fifth, it was clear to Members of the Financial Services Committee as well as a majority of the rest of the House of Representatives that Congress needed to act to maintain investor confidence in America's capital markets. The resulting Sarbanes-Oxley legislation was designed to improve corporate governance by holding Boards of Directors more responsible for their oversight of the corporation, holding CEOs and CFOs to task if they knowingly signed off on inaccurate financial statements, strengthening auditor standards, and forcing publicly traded companies to review and if need be improve their internal controls that ultimately lead to the production of their financial statements. Let me say Mr. Chairman that in the eight years that I have sat on the Financial Services Committee, Sarbanes-Oxley is one of the two most significant

pieces of legislation the we have passed along with Graham-Leach-Bliley which repealed the depression era Glass-Steagal Act. In some ways SOX is more significant because it affects all publicly traded companies and not just the financial sector.

After Sarbanes-Oxley was passed and the Public Company Accounting Oversight Board was created, the PCAOB had opened public company on their proposed rulemaking for Section 404. Even then, comments that were received by the PCAOB from companies such as Microsoft addressed concerns that the audit of internal control, where a public auditor must attest to the soundness of a company's internal control system, would significantly increase the cost of the public audit.

During this time period, my office began conducting meetings with a small group of Tier 2 and Tier 3 accounting firms. The purpose of the meetings was to determine if the potential increase in the audit cost could be minimized by having the 404 work subcontracted to smaller accounting firms. Under SOX there is some leeway for the public auditor to "rely on the work of others" in providing their attestation on the soundness of the 404 audit. Not only did I suggest this to the PCAOB in writing during their comment period, my office also arranged a meeting with Members of the National Association of Black Accountants and the PCAOB

to discuss these issues. Unfortunately, this option was not deemed viable by the PCAOB due to potential supervisory constraints between the major auditor and the subcontracted company.

We are now fours years from the passing of Sarbanes-Oxley and the jury appears to be deadlocked. Without question, Sarbanes-Oxley has achieved its goals in relation to improved corporate governance. As you know I have joined Messrs. Kirk and Feeney, in a listening tour of companies that have to deal with Sarbanes-Oxley compliance. Companies listed on NASDAQ, NYSE, and Members of the Chamber of Commerce seem to concur on the corporate governance issues. There is a consensus that Board of Directors have taken their fiduciary responsibilities more seriously, including meeting more, acting more independently of management, particularly in relation to the audit, and improving communication with shareholders.

Many companies have expressed how Section 404 has forced them to review and tighten their internal controls, making them a more efficient and secure company. This is clearly a part of what SOX was meant to do. However, some of our intentions have backfired, and we are forced to recognize that phrase that we hate here as legislators, “unintended consequences”.

Although, there are several issues related to 404 compliance cost that I could mention, for the sake of time I will limit my concerns to two issues. The first is the effect that the significant cost in financial and human resources of SOX implementation is having on small cap companies, particularly biotech. The second is the overall cost to our capital markets from companies that have de-listed, not listed, or have listed overseas.

According to a survey conducted by Financial Executives International, member companies spent an average of $4.3 billion for costs associated with internal control compliance. I have heard of companies going from approximately $400,000 for audit costs to over $1,000,000. According to that same FEI study, companies with revenues over $25 billion spent an average of more than $14 million. The reality is that large cap companies can absorb these cost, but small cap companies cannot.

In New York City we have an enclave of bio tech firms. These are small firms whose primary business is Research and Development in healthcare, agricultural, industrial and environmental biotechnology products. In other words their research leads to quality of life improvements to include cancer related and other types of

life-saving products. For many of these companies, documentation and testing of internal controls is the responsibility of their internal audit departments. Since in most cases these are only few staff, many of whom are part-time, these companies now have to hire additional personnel or engage outside consultants to perform the required internal control testing. Many of the smaller biotech companies have had to redirect 10 percent of their full time employee resources to comply with SOX. These costs have ranged from $300k to $500k for increased internal staff, and $800K to $1 million for external consultants.

I'll give you an example:

A New York Biotech Company that works on spinal cord injuries with public market capitalization of $99M. It has 65 employees and survives on capital raised every round. Its spending rate: $4M for Clinical trial - R&D- for a possible product to cure spinal cord injury.

If it spends $1M on SOX compliance that equals 25% of budget . That is an opportunity cost of $1million dollars that is not being spent on research to benefit humanity. I know that it was not the intention of the Financial Services Committee or this Congress as a whole to divert funds from life altering research.

My second concern, particularly as a Member from New York is the issue of public listings of companies. 68.7 percent of companies are listed in the New York Stock Exchange, NASDAQ or the American Stock Exchange. This is a major artery in the life blood of the New York economy. According to Citigroup, as of the year 2000, nine out of every ten dollars raised by foreign firms through new stock offerings was done in New York. In 2005, that nine out of every ten has moved to London and Luxembourg. In addition, hundreds of small corporations have already delisted.

This is a quote from the March 17, 2006 article in the Houston Business journal::

> "Today, hundreds of U.S. companies are considering tapping the London exchange's AIM as a promising source of quick capital. Faced with costly compliance requirements under Sarbanes-Oxley regulations passed four years ago in the U.S., a growing number of smaller domestic companies suddenly are more open to the idea of crossing the ocean to use the more lightly regulated AIM. The overseas option is being weighed against U.S. exchanges such as Nasdaq."

As a member of the International Relations Committee, I am all in favor of the development of other countries, but not by creating an unfair advantage against American companies and American markets.

Let me close by saying that I am not going to offer any particular solutions today although I have certain remedies in mind. At this point I am still in the mode of listening to companies, American and foreign, so that when I offer a solution or support the solutions of my colleagues, I will feel comfortable that we have heard and considered the best options before choosing any and possibly creating a bigger problem. It is also important to me to hear from more minority firms who too often are left out these discussions and in turn the solutions and I invite my colleagues to of course join me in this.

As my fellow Members at this table know, the resolution to the unintended consequences created by Sarbanes-Oxley is not a democratic or republican issue. It is an issue of American economic health. Something that concerns us all. I hope to work with Members on both sides of the aisle on solutions that are good for corporate America, its labor force and our capital markets.

Thank you for this time.